

TAIWAN'S TELECOMMUNICATIONS REFORMS

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Taiwan's Telecommunications Reforms

Overview

Taiwan's state-owned telecommunications system is highly profitable. But traditionally most of the money earned from it has been transferred to the government rather than reinvested. In 1993, for example, the Directorate-General of Telecommunications had a surplus of NT\$31 billion; it handed over NT\$25 billion to the Treasury.

As a consequence, telecommunications development has been retarded. Telephone density in June 1994 was 38.9 per 100 people, or 106.3 telephones per 100 households—about the same level as South Korea but far behind Hong and Singapore.

Telecommunications is now regarded as a key development area, with the goals domestically of raising teledensity to 50 per 100 people by 2000 and internationally of making the island a regional communications hub serving the financial, shipping and tourism industries. Promised investment, however, is slow in coming. Of US\$4 billion pledged for the sector under the tenth Four-Year Plan (1990-93) only US\$3.3 billion was delivered.

But changes are afoot. In January this year parliament—after three years of consultation—finally passed three telecommunications bills which should foster the development of the island's telecoms industry. The main thrust of the bills is towards privatisation/liberalisation, especially in areas involving technology developed recently or still being developed. However, question marks remain over the degree to which competition will be allowed in such traditional areas as fixed lines.

Taiwan's telecommunications labour union, which fears an undermining of the terms and conditions of employment of its members, has also firmly resisted moves to privatize and liberalize the sector, forcing a compromise at the legislative stage which gives labour direct representation at board level. Such opposition could force developments to take place at a slower rate than envisaged by the island's telecoms reformers.

Background

Understanding Taiwan's development over the last 30-40 years is vital to understanding the challenges facing telecommunications in Taiwan.

Since retreating to Taiwan in 1949, the island's Kuomintang (Nationalist) government has played a key role in shaping the island's development. But rather than direct

intervention, it has preferred to play the role of facilitator, creating the conditions in which Taiwan's small and medium-sized enterprises can thrive. This has meant concentrating on three things: policies aimed at encouraging business, infrastructure construction and protecting new industries from competition in their formative stages.

The key first step in this direction was an investment encouragement statute passed in 1960 aimed at boosting the establishment of new firms, the reinvestment of profits and—above all—the development of export-oriented products. Once the export drive was successfully under way, the government turned towards infrastructure development. In 1973 it launched its Ten Major Development Projects programme, which when completed was followed by another 12 schemes in 1979 and 14 more in 1985. More recently the government's tendency towards grandiose schemes manifested itself in its Six-Year National Development Plan, to run from 1991-96, and the goal of turning Taiwan into an Asia-Pacific Regional Operations Centre (APROC) for multinational business. The Six-Year National Development Plan was a programme of infrastructural investment aimed at realising annual economic growth of 7%. Originally the plan envisioned spending of US\$304 billion, but with the government running up a huge deficit to finance projects in its first three years, the budget was cut back to US\$223 billion.

Taiwan continues to stress the importance of establishing itself as an Asia-Pacific regional operations centre for multinational and international business. Its concrete plans for realising its goal focus on improving Taiwan business environment by developing ten to 20 new high-tech industrial parks, improving port facilities at Kaohsiung, expanding Chiang Kai-shek International Airport and—crucially—introducing reforms to banking and finance, telecommunications and the media. All of these three areas require huge liberalisation and opening to foreign investment if Taiwan wants to achieve its goal of becoming a regional operations centre.

Liberalisation, however, runs counter to the third reason for Taiwan's success: the government's protectionist tendencies. Foreign, especially American, multinationals have established themselves in Taiwan, but they have constantly been denied the freedom to overwhelm the island's small and medium-sized firms. These protectionist tendencies still exist today: moves to open the energy sector to private sector investment only began in 1995. Possibly the one thing that could force Taiwan to accelerate the pace of its economic liberalisation and opening to foreign companies is the prospect of membership of the World Trade Organisation.

The Taiwanese government is also trying to encourage the development of larger firms. While Taiwan has thrived on the back of small and medium-sized businesses, the government believes larger firms would enable economies of scale to be exploited and, particularly important, they would be able to afford significant research and development programmes.

Telecommunications comes into this in various ways. Ultimately, Taiwan's government appears to have decided that the island's greater good would be served by opening up the sector rather than continuing to milk it as a cash cow.

One reason for this is simply to improve services, that have become relatively moribund under the operation of a state-owned monopoly. For example, the waiting list for a mobile phone in Taiwan is around eight months. It is not only individuals who are suffering. Acer, Taiwan's biggest computer company and one of its few firms with an internationally recognised brand name, in January this year said it was considering relocating to either Hong Kong or Hawaii if the telecommunications infrastructure on the island was not improved. The company said Taiwan lacked the telecommunications facilities and services needed by multinational companies. It blamed government red tape for most of the problems.

Another motive for the privatisation programme is that a single company would not be able to cope with the range of technologies and skills needed to develop the national information infrastructure the Taiwan government envisages the island establishing over the next decade. By allowing competition, companies will be able to develop skills in specific areas such as data communications services, multimedia, broadband networks, etc.

The liberalisation bills

Main points:

- * Separation of regulator from operator. Until now, the Directorate-General of Telecommunications has been Taiwan's operator and regulator; it will retain its regulatory function but services will be run by a separate company, China Telecommunications Corp (also referred to as Chunghua or Chung Hua Corp). China Telecom, which will operate both basic and mobile services, will eventually be floated and privatised, probably over a five-year period.
- * Telecommunications services will be divided into two types:

Type I: Primary infrastructure and basic services. These will be largely operated by China Telecom. Foreign companies will be allowed into this sector, but they will not be permitted to hold more than 20% of any company involved in Type I projects. Last year it had been announced that foreign companies would be allowed to hold up to 33%, but this figure was revised downwards by legislators.

Type II: Value-added services, including data communications, Internet services, domestic satellite communications. There are no restrictions on foreign ownership of companies involved in Type II projects. Mobile communications (cellular phones and paging services) are currently regarded as Type I services but will be reclassified as Type II services this year.

- * Services not covered by the bill, for example, services yet to be invented or introduced to Taiwan, will be subject to examination by the DGT to determine which category they will fall in.
- * International services will remain under the control of China Telecom and are unlikely to be opened to competition for at least five years.

Effects of the bills

Competition

When put under pressure by call-back services in the early 1990s, the DGT responded by cutting prices sharply for large corporate customers—from more than NT\$35 a minute to less than NT\$20. The move worked—it regained a lot of the business it had lost to overseas call-back operators.

What this suggests is that China Telecom probably has the business abilities and skills to compete in the future. Indeed, it will probably prove a fearsome competitor for newcomers to the field. The issue here is whether the new DGT will be able to establish conditions which allow other companies to grow and thrive, or whether it will prove amenable to its former other half.

Interconnect policies have yet to be drawn up. The current line of the DGT is that interconnect fees should be at commercial rates; maintaining this would obviously be of great benefit to China Telecom, and a huge barrier to entry to new players.

Moreover, users of fixed-line residential services are currently subsidised by international callers as part of the government's universal service outlook. While this could be viewed as a potential economic liability it can also be seen as a barrier to entry—especially while China Telecom maintains its monopoly over international services.

The problems created by cross-subsidies and the inherent difficulty of calculating what a commercial rate is should also play in China Telecom's favour. Mobile communications generated about three-quarters of the DGT's US\$1.4 billion profits last year from, although it only generated about one-quarter of its US\$5.1 billion revenues. China Telecom would clearly have a lot of room for manoeuvre if it wanted to cut prices to see off competitors, in much the manner that it has tackled call-back services.

Mobile communications

Mobile penetration is low in Taiwan: at just over four phones a 1,000 people, it is marginally better than South Korea but less than half that of Singapore and 40% of Hong Kong. Licences for at least one new mobile and one new paging service to

compete with China Telecom's services are expected to be issued before the end of 1996.

The rules for mobile communications have been criticised because of the way they split Taiwan up into three areas. Companies will have to bid for licences for each of these areas separately. While this should encourage smaller companies to bid for just one of the areas, anyone operating in just one or two would find themselves at a disadvantage when competing with China Telecom, which already operates across all of Taiwan.

Issues for foreign companies

While the liberalisation of Taiwan's telecommunications sector will offer opportunities to foreign companies—who will at least be finally allowed to participate in the sector—these opportunities are unlikely to prove unarguably attractive.

One reason for this is Taiwan's relative isolation. The goal of establishing itself as a regional operations centre for multinational centres can at best be described as optimistic. In particular, while it has no direct links with China, it is impossible for it to claim to serve the country that would obviously be the main target of any companies wanting to set up their regional business in Taiwan. Because of this domestic demand will drive most of the expansion of telecoms demand. The exception to this, of course, will be if China and Taiwan establish direct communication links. While this is unlikely in the near term—say two years—it is almost certain, barring major incidents such as a Chinese invasion or blockade of the island—within the next five years.

Closer to home, because the DGT has to consider any new type of services and determine whether they are acceptable for investment by overseas companies, inevitably there will be delays in entering new markets that might emerge. This could prove a major barrier to foreign companies looking to take advantage of a technological/service advance by entering the market first.

In a similar vein, Taiwan's regulatory regime under the new DGT is very much an unknown quantity. Guidelines have yet to be drawn up, and it may take several years before the overall thrust of the DGT's policies can be clearly determined. Operating in such an unclear environment would suggest that many companies might adopt a "wait-and-see" attitude. This is especially likely as regards competition policy, where it is unlikely the DGT—which has been resisting liberalisation over the last few years—will change its approach overnight.